COMPETITION ISSUES IN ENTRUSTING THE PROVISION OF PUBLIC SERVICES TO A THIRD PARTY AGAINST REMUNERATION — THE CASE OF URBAN PUBLIC TRANSPORT IN POLAND

Abstract

More public authorities nowadays engage specialised undertakings to perform public services. This raises questions on the applicable rules to the selection of public service providers as well as their remuneration for public service delivery. The paper discusses the models of providing urban public transport services in the EU and in Poland and the consequences of adopting ones in the context of the EU common market, in particular resulting from the public procurement and state aid rules. The very common model in Polish cities which consists of the co-existence of the Public Transport Authorities (the organisers of local public transport) and the operators (carriers) who are budgetary establishments or publicly-owned commercial companies, where ‘the internal provider exception’ under public procurement rules is applicable, the compliance of the public services financing with state aid rules remains to be challenging for public authorities.

Key words: services of general economic interest, competition, public procurement, state aid, compensation.

Introduction

Providing local public transport in Poland is the responsibility of the commune (gmina) (article 7 par. 1 point 4 of Act of Commune Self-Government).¹ The Commune may provide public transport services itself or entrust them to third parties. In the light of the European law it is irrelevant if public services (so-called services of general interest) are delivered by public entities or private. The EU is based on the principle of neutrality with regard to property rights, as referred to in article 345 TFEU.²

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¹ Journal of Laws 1990 no. 16, item 95.
European concept of “services of general interest” relate to services that are usually outside the scope of markets (e.g., security, justice) as well as services of general economic interest (e.g., energy, transport). The Commission is of the opinion that Member States are best placed to decide what to consider as being “of general interest”. It intervenes only in the case of manifest errors or misjudgements [Communication from the Commission 2012 point 48, Case T-289/03 BUPA par. 166, Case T-17/02 Fred Olsen par. 216]. At the same time the Commission has stressed that an activity is of general economic interest only if it exhibits special characteristics as compared with the general economic interest of other economic activities [Communication from the Commision, 2012: point 45; Cases C-179/90 Merci convenzionali porto di Genova, par. 27]. However, the Member States’ discretion is limited where EU sector – specific rules have been adopted. This is a case of transport which has always had a special place in the European integration project. The rationale for specific regulations in the field of public transport services lies in the growth of extensive market for these services and a number of undertakings bidding for public service contracts across the Union [Commission, 2006].

The main EU act regulating public passenger transport by rail and road (including urban public transport), is the Regulation (EC) no. 1370/2007. The Regulation is based on the following premises:

- local public authorities should have free choice between organising transport themselves or contracting an external provider;
- since more authorities nowadays engage specialised companies to provide public transport services, fair competition and transparency throughout the Union should be ensured for all undertakings seeking public service contracts;
- although it is characteristic for some public services that they are not commercially viable the mechanism of calculating compensation from public funds for providing them by a third party must be clearly defined and does not distort competition within the common market.

In subsequent parts the paper discusses these three issues which correspond to three research questions posed by the author. Firstly, what are the admissible models of providing urban public transport services, which of them are used in Poland most frequently. Secondly, what are the consequences of adopting ones in the context of the EU common market, in particular resulting from the public procurement and state aid rules. Thirdly, under what circumstances the compensation for public service delivery falls outside the scope of state aid regime. Answering the questions involves literature review and documentary analysis,

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including national and the EU legislative documents, statistical bulletins and cases dealt with by the Commission and the EU Court of Justice.

**Regulatory models of providing urban public transport services**

It should be noted that regulatory models of providing urban public transport services are diverse across Europe. They vary from country to country, and even from city to city. It remains true also in reference to Polish cities. However, there is a general trend in Europe: the growing usage of contracting and the growing usage of some form of competition in the award of operational rights to operators [van de Velde et al., 2008].

Didier van de Velde, Arne Beck, Jan-Coen van Elburg and Kai-Henning Terschüren conducted in 2008 a study concerning organisational forms in which urban public transport services are delivered in Europe. They identified four main groups of organisational forms [van de Velde et al. 2008]:
- in-house operations;
- route contracting under competition;
- network contracting under competition;
- deregulated regimes (free market initiative with additional contracting).

Certainly, in a number of cases allocating an individual case to one of the above-mentioned organisational forms is problematic due to their complexities. However, developing a typology of the organisational forms in which urban public transport services are delivered in Europe provides a better understanding of a problem. They vary, especially taking into account risk allocation and the award procedure.

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<td><strong>Organisational forms in urban public transport in the EU</strong></td>
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| **In-house operations** | Public authorities provide a service directly themselves or through a publicly owned operator and there is a monopoly of public transport provision. However, it can also be a consequence of granting a temporary (exclusive) right to an provider, who, in many instances, for historical reasons occurs to be publicly owned. |
| **Route contracting under competition** | Public authorities decide on transport and social policy goals and state their “public service aims” (central planning); then competitive tendering is organised and providers of the services (prior designed by the authorities) are submitted to gross-cost contracts. |
| **Network contracting under competition** | The tendering includes not only the issues of the realisation of the services (as in the previous case) but also their designing. The authority decides only on the requested standards of the services and then there is the tendering of all services, area-wise or for the whole urban network. |
**Deregulated regimes with additional contracting**

Free market initiative where additional contracting concerns, inter alia, compensation for fare rebates for specific target groups. Apart from that, special requirements may be imposed for the service providers, nonetheless they are valid for all entrants and may refer to such issues as: operating according to published fares and timetables, with a minimum level of frequency, using vehicles accessible for prams and passengers with reduced mobility, etc.

Source: own elaboration based on van de Velde *et al.* (2008).

In a similar vein, Wolański [2011] distinguished four key international models of public transport organisation. These are: the German model, the French model, the London model and the British model. The German model is based on the monopoly of a publicly owned operator, who is responsible for both: network planning and the realisation of the service. The model corresponds to the in-house operations model by van de Velde. The French model is in fact the network contracting under competition model, where the subject of the tender covers the management of the entire network and the delivery of transport services – for a prescribed period of time. Usually, though, there is a limited number of transport companies who take part in tendering procedures. The London model constitutes the route contracting under competition model, which is based on the division of the network into a smaller parts, which are tendered separately. In contrast to the previous model there is a large number of tenders in a city and the tendering lots are of the relatively small size. Lastly, the British model, popular within UK except from London, refers to a situation, where more than one operator may serve the similar networks of lines. The operators are to a certain degree co-ordinated by public authorities, who also contract the services which are not profitable.

In Poland the local government (the commune) may carry out the tasks concerning the provision of local public transport:

- itself, in the form of budgetary unit (*jednostka budżetowa*) or budgetary establishment (*zakład budżetowy*), which is an organizational unit of the public finance sector that performs separated tasks against payment and covers the costs of its activity from own revenues; (however, it may receive a purpose-defined subsidy from the budget) (art.15 of the Act of 27 August 2009 on Public Finance);
- through a specialised commercial company controlled by a local government (a utility company), which is a separate from the commune entity;
- entrusting the provision of services to external undertakings by way of a civil law contract.

The local authority may also carry out its tasks through other local authorities, on the basis of an agreement or through the inter-commune association (*związek międygminny*).

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In practice, the dominant legal forms in Poland in which urban public transport are delivered are: budgetary establishments and commercial companies controlled by a local government.

The Act of 16 December 2010 on public transport\(^7\) has introduced a fundamental change in the organisation of public transportation in Poland. It involves separating the tasks of an organiser of public transport and an operator of public transport (a carrier). The first one is a respective public authority, who is responsible for ensuring the functioning of public transport in the given area (e.g. a commune). Ensuring does not mean providing itself. To this end, a competent authority, as referred in the Regulation no. 130/2007 should have proper mechanisms at their disposal, which include: the grant of financial compensation to public service operators and the definition of general rules for the operation of public transport which are applicable to all operators; (the Polish Act does not stipulate granting exclusive rights to the operator that is mentioned in the Regulation no. 1370/2007).

An operator of public transport, in Polish context (as indicated above), is usually a budgetary establishment or a commercial company controlled by the commune which is authorized to perform public transport services that are needed and necessary from the point of view of general interest, based on the agreement concluded with the organiser for the provision of such services (a commune). Such agreement takes the form of an internal act or a contract. Referring to the typology by van de Velde et al. [2008] first situation can be described as “self-production”, the latter one as “in-house operation” and means preservation of the municipal monopoly.

However, in many Polish cities local authorities has decided to establish Public Transport Authorities (PTA’s), who are the organisers of local public transport in the area they administer. They are responsible for: the development of the sustainable public transportation development plan, as a basis for organising the transport services conducted by the operator, taking into account in particular the needs of the local community; designing the public transport network and the selection of the operator. Polish Public Transport Authorities mostly cooperate exclusively with an internal operator, but some of them also put transport services out to tender, resembling the London model. The tender usually covers only a minor part of the network and is divided into many separate tendering lots. More about regulatory models of providing urban public transport services in Poland can be found in the work of Wolański, who also argues that the most frequently used in Poland model of the coexistence of a Public Transport Authority and publicly owned operator, which is a monopolist in the field, is the least efficient [Wolański, 2011].

According to the Flash Eurobarometer 382b “Europeans” Satisfaction with Urban Public Transport (2014), Poland and eleven other member states: Latvia, Romania, Hungary, Czech Republic, Bulgaria, Lithuania, Estonia, Greece, 

\(^7\) Journal of Laws 2011, no. 5, item 13.
Sweden, Austria and Luxembourg are the states with the highest proportion of regular users of urban public transport” in the EU. However, a number of passengers of urban transportation in Poland decreases and in 2013 it was only 3620.9 mln of passengers [GUS 2009, 2013, 2014].

Award of public service contracts for urban public transport

There are many practical implications for adopting a given organisational form of providing public transport services resulting from the EU common market rules, notably from the State aid and public procurement rules.

Where an organiser of public transport does not perform the transport services itself, (in the form of a budgetary establishment), nor through a commune company (the “in-house provider exception”), it makes a selection of a public transport operator. The selection is made:

- on the basis of the Act of 29 January 2004 on Public Procurement Law, where the public authority concludes a public service contract and pays the service provider a fixed remuneration, so-called compensation for public service obligation, or
- on the basis of the Act of 9 January 2009 on Concession for Works and Services, where the remuneration consists principally in the right to exploit the service economically, the operational risk lies with the public service operator, or
- by directly awarding a public service contract (i.e. without any prior competitive tendering procedure).

The last option is admissible only in the case of small-scale transport services or a minor value of the services, (i.e. where the average annual value of the services is less than EUR 1 000 000 or where they concern the annual provision of less than 300 000 kilometres of transport services; in the case of small and medium sized entrepreneurs operating not more than 23 vehicles, these thresholds may be doubled). Moreover, the direct award is also admissible as an emergency measure in the case of a disruption of services or the immediate risk of such a situation (art. 5(4) of the Regulation (WE) no. 1370/2008).

However, in Polish context, very frequently, the in-house provision is the case. Therefore, it should be noted that “in-house” exception (so-called Teckal exception) in Public procurement law refers only to a situation where the control exercised by the public authority, (alone or with other public authorities), over the operator, who is legally distinct entity, should be similar to that which is exercised over its own departments (the “control criterion”). Moreover, the main part of the activities of the operator should be conducted with the controlling public authority (the “activity criterion”). When both conditions are fulfilled public

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8 Journal of Laws 2004, no. 19, item 177.
procurement rules do not have to be applied [Wiggen, 2014]. A couple of questions may be raised on the application of these criteria in practice. Firstly, whether the public authority should possess total ownership in the operator in order to apply “in-house exception”. Factors that should be taken into account while determining whether the public authority exercises required control over the operator are enlisted in Article 5 (2a) of the Regulation no. 1370/2007 and these are: the degree of representation on administrative, management or supervisory bodies, the relevant provisions in the statutes, the ownership structure, the influence over strategic and individual management decisions. The same Article stipulates: “100% ownership by the competent public authority, in particular in the case of public-private partnerships, is not a mandatory requirement for establishing control within the meaning of this paragraph, provided that there is a dominant public influence and that control can be established on the basis of other criteria”. Similar provisions are included in the new Directive no. 25/2014 on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC. However, the EU Court of Justice has long held position that it is enough that a private undertaking holds even a minority share in the capital of the operator that rules out the application of the “in-house exception” [Semple 2012: 1; Case C-26/03 Stadt Halle, par. 49–50; case C-215/09 Mehiläinen, par. 3210]. This is a very significant change in determining the satisfaction of the “control criterion”, since previously even a minority participation of a private undertaking in the capital of an operator, without exception, resulted in not fulfilling this criterion. This, in turn, as Wiggen [2014: 86] argues leads to greater flexibility on the part of the contracting authority, what “has some negative effect on competition, as indirect and in some cases even direct private investors will be able to enjoy the benefits of being awarded public contracts without a call for tenders, which gives them an obvious competitive advantage over their competitors. This is especially so when the new provision is read in connection with the introduction of what appears to be a more lenient activity criterion”. However, this change in approach to the control criterion should be considered desirable from the point of view of potential areas for establishing public-private partnerships.

Not only the “control criterion”, but also the “activity criterion” is approached differently in the EU law. Due to the much debate on the extent to which the public procurement rules apply to cooperation between different public sector entities and entities within public sector, a new Directive 2014/24/EU of 26 February 2014 on public procurement and repealing Directive 2004/18/EC has been issued; (date of transposition: 18/04/2016). According to the Directive, in order to satisfy the “activity criterion” more than 80% of the activities of the operator must be carried out in the performance of the tasks entrusted to it by the contracting authority. This percentage should be calculated on the basis of the average total turnover, or an appropriate alternative activity-based measure such as costs.
incurred by the relevant operator or contracting authority with respect to services, supplies and works for the three years preceding the contract award. This provision provides for greater certainty, since previous judgments of the EU Court of Justice left much doubt on the matter [e.g. Case C-340/04 Carbotermo, Case C-295/05 Asemfo]\textsuperscript{11}. More detailed study on the new rules on co-operation in the public sector is provided among others by Wiggen [2014].

Compensation for public transport service delivery

It is worth mentioning that while public procurement rules do not normally apply in a situation when public authorities decide to provide a service themselves or through in-house provider, State aid rules are applicable regardless of the legal status or the nature of the operator providing the services. The application of State aid rules depends on the ‘economic’ character of the activity performed by that operator. However, any activity of supplying goods or services in a particular market is regarded as an economic activity within the meaning of the EU competition rules [Case C-118/85 Commission v Italy, par. 7, Case C-35/96 Commission v Italy par. 36, joined cases C-180/98 to C-184/98 Pavlov and Others, par. 75\textsuperscript{12}, Communication from the Commission, 2012; point 11]. Thus, state aid rules are applied to public services (services of general interest) to the extent that they involve the performance of economic activity by an undertaking.

The EU State aid control in the field of services of general economic interest (public services) focuses mainly on ensuring that the amount of compensation granted to the public service provider is limited to what is necessary to cover the costs incurred in discharging the public service obligation and does not unduly distort competition in the common market.

The EU Court of Justice in its Altmark judgement\textsuperscript{13} ruled that where four specific conditions are satisfied, compensation paid to finance public service delivery falls outside the scope of state aid regime (i.e. does not constitute state aid), (compare them with article 5 of the Regulation no. 1370/2007). Firstly, there must be an entrustment act clearly defining the public service obligation (a “PSO”). It may take the form of a legislative act, an individual decision or a contract depending on the law of the member state and the applied model of providing public services. An entrustment act should specify certain core features of the services. In the case of transport sector it should, for instance, clearly define the geographical areas concerned. Secondly, the parameters for calculating the compensation must be established in advance in an objective and transparent manner.

\textsuperscript{11} Case C-340/04 Carbotermo [2006], ECR I-4137; Case C-295/05 Asemfo [2007] ECR I-2999.
\textsuperscript{13} Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH [2003] ECR I-7747.
Moreover, the parameters on the basis of which the compensation payment is to be calculated should be established in a way that prevents overcompensation (third condition) and finally the operator is either selected through a public procurement procedure or the amount of compensation is determined based on an analysis of the costs of an average “well-run” undertaking in the sector concerned (fourth condition). Where at least one of the above-mentioned conditions is not met, the public service compensation is examined under State aid rules.

The most challenging task for public authorities is the calculation of the compensation for public service delivery in such a way that it does not constitute State aid.

The matter seems to be simple in the case of small amounts of compensation. Where the total amount of aid granted for the public service provider does not exceed EUR 500,000 over any period of three fiscal years the compensation does not constitute State aid. It is so-called the de minimis aid. For comparison, the de minimis threshold in other areas of economic activity for the years: 2014–2020 amounts EUR 200,000 and for road freight transport EUR 100,000. In the previous financial perspective 2007–2013 this lower threshold was applicable also to road passenger transport and till 2012 there was no separate rules on the de minimis rule for aid granted as a compensation for public service delivery. The only challenging task for national authorities is to ensure that the de minimis threshold is respected, in particular where the operator receives public support also from other resources regardless of the form of the aid and its origin: from the national or the EU resources [Rusche, Schmidt, 2013: 226–227].

Were the compensation of greater value is planned to be granted, the methodology for its calculation should be established in advance, in an objective and transparent manner, to make sure that the compensation does not exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations and reasonable profit. The wording of the fourth Altmark criterion suggests that the award of public service contract by virtue of a public tender procedure is the preferable solution. This is very true in the Commission’s reasoning in other state aid cases [Klasse, 2013; Santamato, 2009]. The operator who is chosen pursuant to a public procurement procedure provided that there is an effectively contestable market and that it satisfies certain minimum conditions (the procedure is open, transparent and non-discriminatory) is deemed to be capable of providing respective services at the least cost to the community, since the amount of compensation corresponds to the market price; (e.g. case N 604/2005 Busverkehr Landkreis Wittenberg, Communication from the Commission (2011), point 43). However, as Klasse [2013: 47], Rusche and Schmidt [2011: 257] rightly argue “a competitive tender procedure […] does not in itself provide a safe harbour from the state aid rules”. In the Busverkehr Wittenberg

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case (mentioned above) the Commission was on the opinion that although the operator had been selected by a public procurement procedure the risk of over-compensation was still present due to the lack of the relationship between the costs incurred by the bus operator, i.e., personnel costs, vehicle costs and fuel costs, and the public support received by the operator (par. 55). Thus the compensation for public transport service delivery in the district of Wittenberg has been recognised as state aid despite the fact that the operator had been selected pursuant public procurement procedure, (the Commission found that third Altmark criterion was not satisfied).

Where public procurement rules are not applied, for instance, in the case of in-house provider, the compensation calculation requires benchmarking with “an average ‘well-run’ undertaking in the sector concerned” which is adequately furnished with means of transport. This, however, may be difficult in the absence of comparable undertakings that could be used as benchmarks. In the Commission’s opinion there are two different things: the costs of a typical undertaking and the costs of a well-run undertaking and simply generating a profit is not sufficient to determine that a given undertaking is “well-run”. In the case C-16/2007 Postbus Lienz16 the Commission argued that the compensation based on standard parameters determined on average costs in the sector does not reflect an efficient undertaking. “In the bus transport sector, which has been dominated by monopolies and in which contracts have been awarded without tenders for a long time, an undertaking operating in the market is not necessarily a well-managed”. Therefore, the Austrian authorities failed to demonstrate that the amount of compensation granted to Postbus AG had been determined on the basis of an analysis of the costs of an average “well-run” undertaking in the sector concerned. Nonetheless, the Commission added that the Austrian authorities could have taken as a basis the average costs in undertakings which had won a significant number of tenders in the sector in the last few years. This would be sufficient to meet the fourth Altmark criterion in the absence of a tendering procedure and provided that the rest of the criteria are fulfilled the compensation granted for public service delivery would not constitute state aid.

Conclusions

Apparently, financing public service delivery does not always escape the EU competition regulations. On the contrary, more public authorities nowadays engage specialised undertakings to perform public services of an economic nature (e.g. public transport services). This, in turn, raises questions on the institutional framework of the cooperation between different public sector entities and entities within public sector, in particular, on the ways in which public service provider is

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selected, as well as the calculation of the compensation paid to undertakings for public service delivery.

The very common model in Polish cities for providing public transport services is the co-existence of the Public Transport Authorities (the organisers of local public transport) and the operators (carriers) who are mostly budgetary establishments or publicly-owned commercial companies. In these cases, “the internal provider exception” under public procurement rules may be applicable, provided that two criteria are satisfied: the control criterion and the activity criterion. Both of them are approached differently in the recent developments in the EU law which may leads to greater flexibility for the contracting authority. However, the compliance of the public services financing with state aid rules remains challenging for public authorities. Where public authorities wish to fall outside the scope of state aid regime and the compensation paid to the service provider exceed the EUR 500 000 over any period of three fiscal years (the de minimis threshold), they should demonstrate that the parameters for calculating the compensation has been established in advance in an objective and transparent manner, that prevents overcompensation (i.e. compensation is necessary to cover all or part of the costs incurred in the discharge of the public service obligations and reasonable profit). The task is much easier where the operator is selected pursuant public procurement procedure while it is then presumed that the amount of compensation represents “the least cost to the community”. Nonetheless, in Polish practice usually it is not the case. Therefore, public authorities are required to determine the amount of compensation on an analysis of the costs of an average “well-run” undertaking in the sector concerned which is adequately furnished with means of transport. That, in turn, may be difficult in the absence of comparable undertakings that could be used as benchmarks.

References


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